



CESTNICK

TAX MATTERS

CRA delays cause tax battle to continue for more than 20 years

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Last week, I shared examples of how the culture at the Canada Revenue Agency has gone wrong. I referred to an investment that has left the investors – over 2,300 of them – fighting the CRA for more than 20 years. Some investors have passed away during this time, leaving their surviving spouses – widows in many cases – to deal with the CRA in their twilight years. Others have literally grown old waiting for a resolution, which they thought was at hand several years ago.

I'm talking about the Sentinel Hill film investment, which raised funds to promote film production in Canada. At the time, promoting film production was a key policy objective for the government. Investors expected good after-tax returns, provided in part by tax savings from deductible business losses that were to be available to investors. Ken Gordon, one of the four principals of Sentinel Hill Ventures Corp. (SHVC), the architect of the Sentinel Hill investment, obtained advance tax rulings from the Canada Revenue Agency for film investments offered in both the years 2000 (known as SH2000) and 2001 (SH2001).

As an aside, an advance tax ruling (ATR) is a written ruling from the CRA that requires the taxpayer to provide extensive details of a strategy that the taxpayer is contemplating, in order to gain the CRA's written confirmation of the tax consequences of the strategy prior to implementation.

Mr. Gordon and SHVC wanted to assure investors in SH2000 that the tax implications would be as expected. And so, he requested, and the CRA did issue, an ATR on Feb. 21, 2000. The ATR suggested the tax benefits would be available to investors assuming certain conditions were met. Despite those conditions being met, CRA challenged the amounts claimed by investors.

"Some of the threats and allegations made by CRA were egregious," Mr. Gordon said. "Only the threat of an appearance in court caused the CRA to discuss a settlement – which was reached in 2004," he continued. After three years of fighting, investors did receive 91 per cent of the amounts claimed and that were supported by the ATR issued by the CRA. "At that point, we just wanted the battle over with, so we agreed to settle on 91 per cent of the tax benefits we

expected, even though we should have received 100 per cent,” Mr. Gordon said.

In the meantime, before the battle over SH2000 began, a second ATR was issued, and more funds were raised for film productions through the 2001 Sentinel Hill film investment (SH2001). The 2001 deal was structured in an identical manner to SH2000, so investors expected that the tax implications would be the same as SH2000 based on the ATRs that had been issued.

Mr. Gordon and SHVC did not want to continue promoting the SH2001 film investment if CRA had concerns about it. “We met with the audit division of CRA on two occasions and had other discussions with the CRA Rulings department in 2001. We met on Sept. 11, 2001 – that’s right, the 9/11 date many of us remember for the terrorist attacks – and CRA said that they had no concerns about SH2001 as it was structured. It turns out that this was false, but the CRA did not communicate any concerns to us.”

Over the next three years, there was silence from the CRA. It should be noted that, after three years following the date on a Notice of Assessment, an individual’s tax return generally becomes statute-barred, which means the CRA can’t typically reassess a person beyond that date (unless there’s been misrepresentation or gross negligence).

On the eve of the three-year anniversary for many of the SH2001 investors, in March, 2005, the CRA issued Notices of Determination to the SH2001 partnership (but not to individual investors) essentially denying 40 per cent of the amounts claimed three years earlier.

SHVC, on behalf of the SH2001 partnership, filed Notices of Objection in June, 2005, objecting to the CRA’s position and to protect the interests of the 2,300 investors, but the CRA failed to appoint an appeals officer to review the objections. “We waited four years for CRA to assign an appeals officer, but they never did. There was silence. So, in July, 2009, we filed a Notice of Appeal that would allow our case to be heard at the Tax Court of Canada,” Mr. Gordon said.

When a taxpayer files a Notice of Appeal, the CRA is forced to deal with the matter more quickly because, otherwise, the department will have to prepare for an appearance in court. So, after filing the Notice of Appeal, SH2001 and its investors finally had CRA’s ear.

But the story isn’t over. There is much to be learned from this story, both about tax planning and, importantly, about the culture at the CRA. I’ll finish the story next time.

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